Alberta Economic Development

Alberta Business Outlook 2003 - 2004

December 2003
Policy and Economic Analysis

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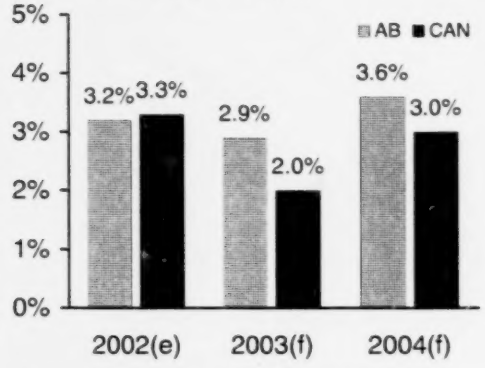
ALBERTA BUSINESS OUTLOOK, 2003 - 2004
DECEMBER 2003

OVERVIEW

Although Alberta's economy was impacted in 2002 by weak US demand, continued weakness in the global manufacturing industry, drought conditions and the events of September 11, it expanded at a robust pace of 3.2 per cent in 2002, because of continued growth in consumer spending and rising net exports (exports minus imports).

The goods producing sector's GDP declined in 2002, because of lower output in the *agricultural, energy* and *manufacturing* industries. However, the service sector continued to expand strongly, with the largest gains registered by the following industries: *wholesale & retail trade, information & culture, finance, insurance & real estate* and *professional, scientific & technical services.*

Real GDP Growth



Sources: Alberta Finance; Statistics Canada; private sector forecasters
e: estimate; f: forecast

Alberta's economy is also performing well in 2003, although growth has been constrained somewhat by the strong Canadian dollar, SARS and the border closures to beef and live cattle, as a result of a single case of mad cow disease. Growth will be similar to 2002, but will be led by the energy industry, as a result of strong oil and gas prices. All private sector forecasters surveyed expect Alberta's economy to perform very well in 2004, as exports and investment are expected to show solid growth, as will the non-residential construction and energy sectors.

Private sector GDP forecasts for Alberta have a wide range for 2003 - from 2.5 to 3.8 per cent growth - with the average coming in at 3.0 per cent. Alberta Finance lowered its 2003 forecast to 2.9 per cent, to reflect the negative effects of mad cow disease, the strong dollar and SARS (on tourism). For 2004, most forecasters expect Alberta to be the top province, with growth forecasts ranging from 2.8 to 4.1 per cent (average is 3.6 per cent).

KEY INDICATORS

High growth in disposable income and employment are positively impacting consumer demand and Alberta's overall economic performance in 2003. This is translating into strong growth for Alberta's consumer oriented service sectors, such as *retail trade* and *finance, insurance & real estate.*

Higher energy prices towards the end of 2002 and in 2003 have led to increased drilling activity, which in turn is positively impacting capital investment. However, the weakening of the Canadian economy, Bovine Spongiform Encephalopathy (BSE), high

natural gas prices and the strong Canadian dollar have likely led to a weakening in international and inter-provincial export volumes in recent months.

Current economic indicators are sending out somewhat mixed messages about Alberta's economic performance in 2003, although the number of indicators with positive growth outweighs those with negative growth.

The following indicators suggest a robust economy:

- During the first 11 months of 2003, total Alberta employment was up 47,100, compared to the same period in 2002,
- The value of international goods exports up 25 per cent in the first nine months,
- The value of manufacturing shipments increased 6.7 per cent through September,
- Crude oil prices averaged about US$31/barrel in the first nine months while natural gas prices nearly doubled,
- The number of wells drilled was up 20 per cent for the January to October period, and the number of active drilling rigs 36 per cent.
- Retail sales rose 4.4 per cent in the first nine months, and
- Wages and salaries up 4.9 per cent in the first half.

Indicators that indicate a softer economy include:

- MLS home sales down 0.8 per cent through September,
- The value of building permits declined by 3.3 per cent for the January to September period,
- The number of housing starts (urban and rural) declined by 3.4 per cent in the first nine months,
- The number of Employment Insurance recipients up 5.9 per cent in the first nine months,
- The number of new motor vehicles sold fell by 3.5 per cent in the first nine months, and
- Farm cash receipts fell 17 per cent for the January to September period.

After creating 41,700 new jobs in 2002, Alberta's employment level is expected to rise by about 46,000 in 2003.

In 2002, farm cash receipts fell marginally to $8.2 billion, mainly as a result of the drought. The latest forecast for 2003 is for a decrease in farm cash receipts: livestock receipts will be down due to mad cow disease and crop receipts because of low inventory levels.

Total production of grains and oilseeds in 2003 is much higher than in 2002, the worst crop year since 1992. However, crop receipts could be weak this year because of very low inventory levels. Livestock receipts are forecast to decline on a year-over-year basis for the first time since 1991. Prices have fallen significantly, especially after the detection of BSE.

Crude oil prices for West Texas Intermediate (WTI) have remained strong in 2003 because of low inventory levels and restraint by the OPEC oil cartel. The US Energy Information Agency (EIA) expects them to weaken gradually in 2004. The price of natural gas averaged just under Cdn$6 per thousand cubic feet in the first eleven months of 2003, at least 60 per cent more than in the same period of 2002, followed by a spike in December as a result of un-seasonally cold weather in the US. The EIA anticipates that they will decline for most of 2004. US gas imports have been weak this year, while

crude oil imports have shown strong growth.

According to the Canadian Association of Oilwell Drilling Contractors, the industry will set a drilling record in 2003, with more than 19,000 wells expected to be drilled in Western Canada. Most of these wells are gas wells drilled in Alberta. Although the number of wells drilled is forecast to decline to just over 18,000 in 2004, this would still be the second largest number on record.

In 2003, forestry product shipments are forecast to increase by almost five per cent, because of recent price increases. An expected cyclical decline in the North American housing market, combined with the US lumber duties and this year's 20 per cent appreciation of the Canadian dollar against the US dollar will result in lower growth in 2004.

Although BSE is affecting the food products sector and the telecom industry has continued to weaken, total manufacturing shipments are forecast to rise by about six per cent in 2003, because of higher commodity prices. The manufacturing sector could see shipments rise by approximately eight per cent in 2004, as a result of the expected rebound in the telecom industry and strong growth in world trade volumes and in the economies of Alberta's major trading partners.

The global downturn in the information and communications technology (ICT) sector has impacted Alberta's ICT sector, especially the telecom equipment industry. The telecom industry saw large declines in production and exports in 2001 and 2002, and exports have continued to decline in 2003. The global telecom industry has recently shown signs of recovery, which is expected to lead to a rebound in Alberta's telecom industry in 2004.

Alberta retail sales rose 7.9 per cent in 2002, the largest increase of all provinces. Retail sales are growing less strongly this year, partly because of declining car sales, but are still forecast to increase by five per cent for all of 2003 because of high consumer confidence, strong employment gains and low interest rates. In 2004, retail sales growth is expected to remain strong at six per cent, because of a stronger economy, high consumer confidence and solid employment gains.

Alberta's tourism industry is in one of its worst years in recent history, because of the effects of Severe Acute Respiratory Syndrome (SARS), a struggling US economy in the first half of this year, the uncertainty associated with the restructuring of Air Canada, and continued sluggishness associated with the recovery of business travel. Alberta is better positioned than many of its competitors and can look forward to a better year in 2004, with all four market segments, Albertans, other Canadians, the US and overseas travelers, expected to grow strongly. These anticipated increases, however, occur against the backdrop of several years of declines from most of Alberta's key international markets.

The demand for new housing has surged in recent years because of the strong Alberta economy and population growth. This led to exceptionally robust growth in both single-detached starts and in multiple starts. Housing starts totaled 38,754 in 2002, the largest number of starts since 1979. Total starts are forecast to decrease to a still strong 36,000 units in 2003.

Total construction is expected to remain fairly flat in 2003, as much

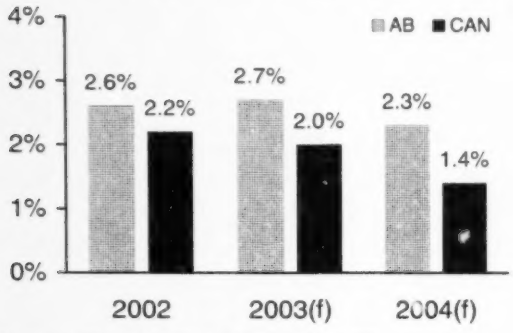
higher investment in conventional oil and gas projects is offset by lower oil sands activity. The Alberta Construction Association (ACA) forecasts that construction expenditures will grow by 5.2 per cent in 2004. This growth will mainly be the result of increased oil sands development activity.

EMPLOYMENT

A total of 41,700 net new jobs were created in 2002, because of the expansion of the service sector and strong in-migration. Net migration, the difference between the number of people coming into Alberta from other provinces and other countries and the number of people leaving Alberta, totaled 27,084 in 2002.

Employment gains remain strong in 2003, as strong economic growth is causing labour demand to rise. Job growth has been strongest in the energy sector, because of high energy prices. For the first eleven months of 2003, average employment rose by 47,100. This year-to-date increase exceeds private sector forecasts, which average 42,500 for all of 2003, an increase of about 2.5 per cent from 2002. The consensus forecast is for employment growth of two per cent for all of Canada.

Employment Growth



Sources: Statistics Canada; CBoC; AED

Labour demand is forecast to increase strongly in 2004, and as a result the unemployment rate can be expected to continue to decline. Employment levels could increase by 40,000, in line with the consensus forecast of 36,500. Although workforce shortages have eased somewhat, they will continue to be a major challenge in 2004.

DOWNSIDE RISKS

There are three downside risks to this outlook:

- If the recent slowing of the Canadian economy persists or growth in the US weakens, possibly because of the lack of job creation, Alberta's trade performance will weaken.
- Most private sector forecasts assume that the BSE crisis will be fully resolved in a few months time. If the export ban for live cattle remains in place longer than anticipated or beef exports continue to suffer from bans or other trade barriers, economic growth will be impacted.
- The recent strength of the Canadian dollar is having an impact on Alberta's export performance and on the profitability of Alberta companies.

SOURCES OF GDP GROWTH

Alberta's GDP advanced by 3.2 per cent in 2002, because of strong growth in consumer spending. Capital investment declined. Even though export growth was minimal (0.3 per cent) because of a drop in international exports, net exports (exports minus imports) grew strongly as imports fell marginally. (Note: in this section exports and imports include both international and inter-provincial trade.)

In 2003, growth in domestic demand is forecast to be higher than in 2002, mainly because of inventory re-building. Capital investment could rise marginally, as strong growth in the conventional oil and gas sector will offset a sharp decline in oil sands development (as a number of major projects are finished or wind down). Growth in personal spending could be slightly lower than in 2002.

International export volumes will likely again be down: gas exports to the US were lower in the first nine months, as were manufacturing exports. BSE will affect exports of beef and especially live cattle for much of the remainder of this year, while last year's drought continued to depress crop export volumes. Net exports will also likely fall, as imports are forecast to increase.

The consensus forecast, the average of six private sector forecasts, for 2003 GDP growth is 3.0 per cent. On August 27, Alberta Finance released its forecast of 2.9 per cent growth for the Alberta economy in 2003.

For 2004, GDP growth is forecast to rise to 3.6 per cent (consensus forecast), mainly because of recoveries for exports and investment and continued strength in consumer spending.

Personal expenditures on goods and services grew by 2.8 per cent (adjusted for inflation) in 2002, as a result of strong growth in consumer durables, such as cars and appliances. In 2003, growth is forecast to be closer to 3.5 per cent. New car sales have been declining in the first eight months of 2003, but overall retail sales and home renovation spending continue to grow because of strong consumer confidence and employment growth. For 2004, growth is forecast to reach nearly four per cent.

Investment in structures and machinery and equipment fell by 1.8 per cent in 2002, as strong growth in residential investment and in machinery and equipment could not offset a sharp drop in non-residential structures. Statistics Canada reported in July that investment intentions for 2003 are two per cent lower than for 2002 investment, mainly as a result of a sharp decline in oil sands development. High energy prices have led to strong growth in conventional drilling activity – likely substantially higher than Statistics Canada's nine per cent growth. In 2004, investment activity is forecast to increase, as conventional drilling is expected to remain strong and oil sands investment rebounds.

Export volumes increased marginally in 2002, but the value of international exports was down 14 per cent from the previous year, because of lower prices. Inter-provincial exports were higher, as most other provinces had fairly strong economic growth in 2002.

In the first half of 2003, economic growth in the US and Canada was weaker than in 2002. As a result, international export volumes are down, and inter-provincial exports are also likely weak. Although the value of international exports increased sharply by 25 per cent in the first nine months, compared to the same period of 2002, this was solely the result of higher energy prices. Volumes were down between three and four per cent.

Strong growth is expected for export volumes of crude oil and natural gas for 2004, as the US government forecasts imports of these commodities to rise because of low inventories.

Manufacturing exports have fallen in the first nine months of 2003, as the global problems of the manufacturing and ICT sectors continue. BSE has resulted in a 40 per cent decline in export volumes of beef over that same period. As well, California is phasing out the use of MTBE, an ether based gasoline additive, resulting in a $340 million export loss this year. Manufacturing exports are not expected to improve much for the remainder of the year, because the US manufacturing and the global ICT sectors remain weak and BSE continues to impact beef exports.

Alberta import volumes fell by less than one per cent in 2002. For 2003, fairly high growth is expected, because of increased demand from the energy sector. Import volume growth should remain high in 2004, because of Alberta's anticipated higher GDP growth rate and strong drilling activity.

After increasing slightly in 2002, net exports are forecast to fall in 2003. Export volumes could decline in 2003, but imports are recovering. Export volumes will likely rise significantly in 2004, as higher global growth is expected to provide a significant boost to Alberta's exports. We are assuming that most of the international bans on beef and live cattle will be lifted by then. This year's agricultural crop yields are much higher than in 2002, which will mostly affect next year's exports.

AGRICULTURE

In 2002, farm cash receipts fell by 0.6 per cent to $8.3 billion. This decline was mainly the result of two consecutive drought years.

Forecasts for Alberta in 2003, released by Agriculture and Agri-Food Canada (AAFC) in June, were for a decrease of 2.8 per cent in farm cash receipts. This forecast was based on the expectation of a 13 per cent decline in crop receipts (because of very low inventory levels) and no growth in livestock receipts. As this forecast was prepared just prior to the release of the BSE test results, it is too optimistic. Livestock receipts should be significantly lower, while program support payments should rise by more than the forecast four per cent. AAFC plans to release a revised 2003 forecast in late January 2004.

Even though the 2003 harvest was at near normal levels, crop cash receipts are decreasing in 2003, as a result of low inventory levels. Livestock receipts were forecast to be flat in 2003 prior to the BSE incident. However, the reduction in marketings and in prices as a result of BSE are causing a substantial drop in livestock receipts. Official estimates for the first nine months of this year show the dire straits Alberta's primary agricultural sector is in: total farm cash receipts were 17 per cent lower than they were in 2002. Crop receipts were down 14 per cent, while livestock fell 28 per cent. Program support payments rose 44 per cent.

International exports of agri-food products, which include primary and value-added agricultural products, fell sharply by 14 per cent in 2002 to $5.1 billion because of the two drought years. Exports for the first nine months of 2003 fell by 27 per cent, mainly as a result of last year's drought and a sharp reduction in cattle and beef shipments to the US. Exports tumbled by about one-half in June, July and August, because of the import bans of Canadian beef and live cattle. They fell by 17 per cent in September, because of the partial lifting of the import bans and large increases for crop exports. It is anticipated that

agri-food exports will remain weak for at least the next few months.

In 2002, the US imported 511,000 head of cattle from Alberta with a value of $634 million. Alberta beef exports totaled over $1.6 billion in 2002, with $1.3 billion going to the US. Approximately 41 per cent of Alberta beef is exported, with another 46 per cent going to other provinces and 13 per cent consumed in Alberta. An Alberta industry consultant has estimated the direct costs of BSE to Alberta's primary and secondary agricultural sectors at $800 million for the period up to December 1.

The national BSE Recovery Program is a short-term national program designed to compensate producers for the detrimental impact border closures have had on domestic cattle prices. Alberta has committed $100 million to this federal – provincial initiative, and recently announced an additional $300 million in short and medium-term support for provincial producers.

On August 8, the US officially announced the re-opening of its borders to Canadian boneless beef from cattle under the age of 30 months, boneless veal and liver. The first shipments of Alberta beef crossed the US border on September 10. Mexico officially opened its borders to all of the above beef products on September 5. Russia and a number of small markets, such as Jamaica, Barbados, the Philippines, Antigua, and Trinidad and Tobago, have also partly re-opened their borders. Impediments to a full opening of US and Mexican markets for bone-in products and live cattle remain, and key Asian markets stay closed.

At the end of October, draft rules for importing live cattle from Canada into the US were published. Live cattle will not be eligible for export until the 60-day comment period is over, the comments are assessed and a final rule is published. It is expected that cattle under 30 months of age will be eligible for export first. Taiwan, Macau, Hong Kong and China are considering re-opening their borders to Canadian beef. The border closure on May 20 impacted live cattle and beef prices. However, this impact was significantly moderated by government support measures.

The drought and feed shortage last year contributed to the number of Alberta cattle and calves on farms declining by 5.3 per cent, to 6.05 million head on July 1, 2003, compared to the same date last year.

Quarterly hog prices have generally been higher in 2003 compared with 2002. US hog prices are forecast to rise in 2003 and 2004, but the rapid appreciation of the Canadian dollar will offset these gains and exert downward pressure on local prices.

In 2002, a second successive drought contributed significantly to a decline of 6.5 per cent per cent in crop receipts. Prices in 2002 were significantly higher and somewhat moderated the impact of lower sales volumes. The opposite picture is developing in 2003; marketings are increasing strongly, offset somewhat by weaker prices. Although drought conditions and insect infestations impacted production, grain and oilseed yields are significantly higher than in 2002. Overall yields are close to the ten-year average for cereals and hay, and higher than the ten-year average for canola.

Canola production was down sharply in 2002 with lower harvested acreage and yields. Sales were also significantly

lower because of declining inventory levels. Production is forecast to nearly double in 2003, but sales growth will be more modest as a result of the very low inventories.

Two of the largest canola importers, China and Mexico, have sharply reduced canola imports in the last two years because of high prices and low supplies. It is expected that these two markets will return once Canadian inventories are replenished.

Barley production also declined sharply in 2002, but rebounded strongly this year. According to a recent Statistics Canada survey, barley production could be 120 per cent higher in 2003 than in 2002.

Wheat receipts declined by 12 per cent in 2002 to $819 million. Durum receipts were slightly higher than in 2001, as the south was less affected by last year's drought than the rest of Alberta, but non-durum wheat fell by 15 per cent. In 2003, production of spring wheat increased by nearly 80 per cent and of durum wheat by six per cent. A concern to Alberta wheat producers is the recent imposition by the US government of a 14.15 per cent tariff on Canadian red spring wheat.

Overall, the two major factors that are currently influencing grain and oilseed prices are the strong Canadian dollar, which is negatively affecting export prices, and a huge increase in world-wide shipments to China, which has a positive impact on prices.

ENERGY

Low oil and gas prices at the end of 2001 and through the first half of 2002 resulted in conservative corporate investment programs for 2002 and lower activity in the energy industry for most of 2002. However, improving oil and gas prices through the second half of 2002 and into 2003 gave way to strong corporate drilling investment programs since the end of 2002, which extended into the 2003 drilling season.

Revenues for Alberta's energy sector fell to $50.1 billion in 2002. Natural gas sales accounted for more than 55 per cent of these revenues and oil sales for just over one-third. The value of US imports of Alberta energy tumbled by 16 per cent in 2002, because of lower prices, but have increased sharply so far this year.

The recent completions of the Athabasca Oil Sands Project (AOSP) at Muskeg River, the first new major oil sands plant in 25 years, the Scotford Upgrader and Imperial Oil's Mahkeses Project.will result in lower oil sands investment in Alberta in 2003, compared to 2002. However, oil sands investment will remain high over the longer run, as more than $45 billion in investment has been announced, much of it to take place over the next five years.

Within the oil sands industry, historically development focused on surface mining. This continues to be true to some extent, with the announcement of CNRL's Horizon project and Shell's Jackpine expansion. In addition, many proposed projects will use the in-situ method of extracting the bitumen: by heating the oil sands under ground and then lifting the bitumen to the surface in a fluid state.

Increased output from Alberta's oil sands, because of the new AOSP plant (tempered somewhat by maintenance shutdowns at Suncor and Syncrude), and from Newfoundland's offshore deposits, caused Canadian oil production to increase by 2.5 per cent during the first eight months of 2003.

US imports of Alberta crude rose by more than ten per cent in the first nine months of 2003.

The National Energy Board (NEB) expects Canadian crude oil exports to more than double by 2025, as oil sands production continues to grow. Crude oil output could rise sharply in 2004 because of the AOSP plant and the completion of Suncor's Firebag In-situ Oil Sands Project later this year.

Because of Alberta's oil sands, the NEB recently moved Canada up to the number two position behind Venezuela in terms of total discovered recoverable resources of crude oil and bitumen, while the US' Energy Information Administration (EIA) ranks Canada as number two behind Saudi Arabia.

Crude oil prices averaged almost US$31 per barrel during the first nine months of 2003, 22 per cent higher than the price levels achieved in the same period of 2002. Current price levels are supported by a recent surprise cut in OPEC quotas, low OECD oil inventories, stronger world economic growth and political instability in Venezuela and Nigeria (International Energy Agency).

On September 24, OPEC made a surprise 900,000 barrels per day (bpd) output cut, lowering their target to 24.5 million bpd. This decision was founded on fears that rising Iraqi production would swell global oil stocks by 600,000 bpd in the fourth quarter. A further meeting has been scheduled for December 4 to review market developments. Additional cuts below 24 million bpd are seen as unlikely.

The EIA anticipates that oil prices will remain strong through the winter of 2003/04, because of the recent OPEC cuts. Prices are forecast to decline gradually to US$27 per barrel by year-end 2004, as inventories are being rebuilt.

US crude oil demand is forecast to rise by 1.6 per cent in 2003 and by 1.5 per cent in 2004, as economic conditions continue to improve. US oil imports are expected to rise by 7.3 per cent in 2003 and by 2.9 per cent in 2004.

The demand for jet-fuel continues to stagnate in 2003, as a result of SARS and the Iraqi campaign. Air travel and capacity have not grown so far this year, and will likely remain weak for the rest of the year.

After a strong second quarter, OECD oil demand weakened in the third quarter, as a result of low river levels in Europe hampering deliveries and cool summer temperatures in Japan. World oil demand in 2003 is forecast to increase by 1.4 per cent, and demand in OECD countries by 1.3 per cent. Global oil demand is also forecast to grow by 1.4 per cent in 2004 and OECD demand by 0.7 per cent. In both years, much of the growth is expected to come from the US and China.

The fieldgate price of natural gas averaged just under Cdn$6 per thousand cubic feet in the first eleven months of 2003, at least 60 per cent higher than the average for the same period of 2002. This rise was partly the result of low inventory levels. High prices likely also caused Alberta gas exports to the US to fall by five per cent in the first nine months of 2003. In the US, higher gas prices resulted in fuel switching from gas to crude oil, increased imports of liquefied natural gas, and surging US drilling activity, which caused US production to rise by a forecast 2.4 per cent in 2003.

US gas storage levels increased sharply to near normal levels since the summer due to lower demand, which also led to lower prices (albeit still high by historical standards) for the July to November period. However, prices have risen sharply in December, as a result of unusually cold weather and a decline in storage levels in the US. The EIA expects prices to increase modestly over the next few months, but to decline thereafter, because of high inventory levels.

The EIA forecasts US natural gas demand to decline 2.3 per cent for all of 2003 because of the high prices, which discouraged demand in the industrial and electric power sectors, and also due to lower weather-related demand. Demand is forecast to rise by 0.9 per cent in 2004, because of higher economic activity and lower prices.

After 2004, US demand for natural gas is expected to increase strongly, boosted by increased demand for electricity generation. Strong demand growth combined with declining North American reserves will keep natural gas prices at relatively high levels over the medium term.

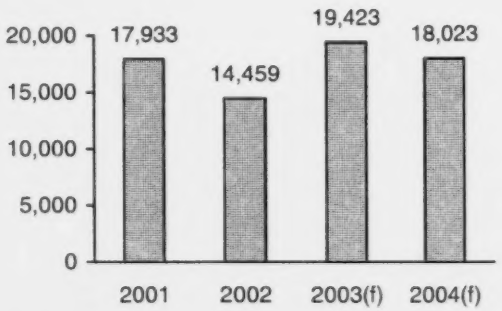
Alberta has seen an increase this year in the amount of exploration and development of coalbed methane gas. In 2000, there were fewer than 50 coalbed methane gas wells in Alberta. By mid October 2003, about 500 wells had been drilled with 180 of these producing.

The Canadian Association of Oilwell Drilling Contractors (CAODC) estimates that 14,459 wells were drilled in Western Canada in 2002, a decline of 19 per cent from the previous year. Of these, 10,545 were completed in Alberta, including nearly 7,000 gas wells.

Higher energy prices have caused drilling activity to pick up sharply in 2003. 14,466 wells were drilled in western Canada during the first nine months, an increase of 37 per cent from the same period of 2002. Gas wells account for 71 per cent of the year-to-date total. It is expected that drilling activity will remain strong over the next few months, because of the recent surge in activity: a record number of wells were drilled in September.

The CAODC forecasts a record number of 19,423 wells for 2003, because of high oil and gas prices. For 2004, the CAODC anticipates that 18,023 wells will be drilled, the second highest number ever, based on averages prices of US$27 per barrel for oil and US$4.75 per thousand cubic feet for gas.

Wells Drilled in Western Canada



Source: CAODC

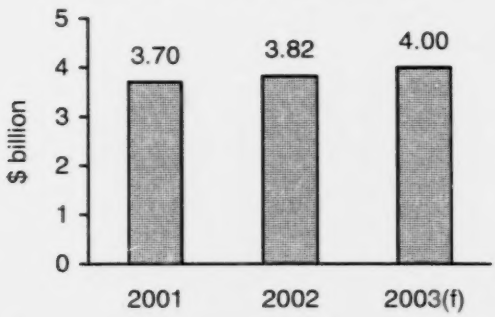
FORESTRY

Even though lumber prices slipped, the value of Alberta's solid wood product shipments increased in 2002, because of higher volumes of lumber, and especially of panel board. Although prices were lower for wood pulp and newsprint, strong volume growth caused pulp and paper shipments to rise by four per cent. Total forestry shipments increased by 3.3 per cent to $3.8 billion.

In the first nine months of 2003, solid wood product shipments rose 2.1 per cent from the same period of 2002, due to recent strength in lumber prices (partly as a result of the BC forest fires), while oriented strand board prices have reached record highs. For the year-to-date, pulp and paper shipments rose two per cent (higher pulp prices).

For all of 2003, Alberta forestry shipments are forecast to rise by about five per cent from 2002 levels, because of recent price strength. Forestry shipments could decline next year, as the North American housing market cools off and because of the recent strength of the Canadian dollar.

Alberta Forestry Shipments



Sources: Statistics Canada; AED

On August 13, a NAFTA panel ruled that the imposition of the duties the US has levied against Canadian softwood lumber was justified, as "the provincial governments, through the tenure and stumpage programs, made a financial contribution to the harvesters of crown timber". However, the US cross-border price comparison used for measuring the benefit lacked sufficient evidence and was also contrary to US law.

A quota-based settlement was reached on December 6 in the U.S.-Canada softwood lumber dispute and is currently being evaluated by Canadian industry interests. It has already received the blessings of the US based Coalition for Fair Lumber Imports. This settlement could, if accepted, result in major duty reductions for Canadian lumber imports. Canadian lumber would be allowed into the US penalty free until Canadian imports account for 31.5 per cent of US softwood lumber demand. Once that level is reached, additional imports will face a $200/Mbf (thousand board-feet) duty. The agreement would also refund 52 per cent of the duty payments that have been made since 2001back to the Canadian firms.

Lumber prices were trading below US$250/Mbf for the first five months of 2003, but rose above this level in June, and have remained fairly strong since then. Recent price strength is the result of low inventory levels in the US and rising demand (especially in Canada) and supply constraints caused by the BC forest fires, the Ontario power outage and severe rain storms in the southern US. Prices could remain strong in the short run because of low inventories, but will likely decline thereafter because of the expected cyclical downturn in the housing industry.

The US and Canadian new housing markets were strong in 2002 and in the first nine months of 2003. However, housing starts will likely weaken in the months ahead, as current activity is running well ahead of demographically supported "sustainable demand". Moreover, US mortgage rates have risen recently and will continue to rise as the US economy improves.

North-central (NC) oriented strand board (OSB) prices fell in 2002, and averaged well below US$175/Msf (thousand board feet) for most of that year. However, OSB prices have skyrocketed since May of this year to

reach a record of US$465 by the end of September. The increase in OSB prices was due to a lack of supply and of transportation equipment.

Prices of northern bleached softwood kraft (NBSK) pulp rose strongly in the first part of 2003 to reach US$580/metric tonne (mt) in April, up from less than US$500 in January, because of the falling US dollar, supply side disruptions and inventory rebuilding. NBSK prices dropped by US$30/mt in July, and have stayed near that level since. Prices of hardwood kraft pulp also remain strong. Strong demand from China is providing support for current price levels.

Newsprint demand (and prices) weakened in 2002 due to the US downturn, which impacted newspaper advertising, and to losses to electronic media. Higher (US denominated) prices were announced in September 2002 and again in March and June of 2003, because of plummeting profits of the large North American producers. However, the strong Canadian dollar erased all of the recent US denominated price gains. World newsprint demand could grow by two to three per cent this year and by four per cent in 2004. Canadian newsprint export volumes rose four per cent in the first eight months of 2003.

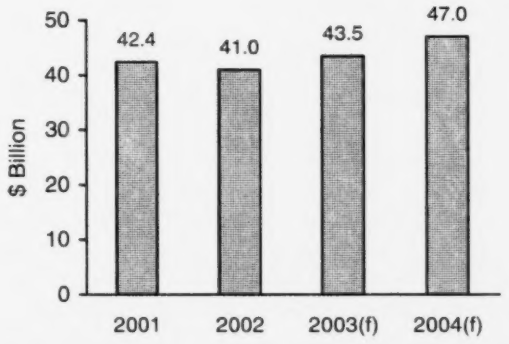
MANUFACTURING

Manufacturing shipments fell by 3.2 per cent to $41 billion in 2002. This decline was the result of lower commodity prices, for instance for petrochemicals, and lower volumes of telecommunication equipment due to the global slump in the Information Technology (IT) industry. Last year's slump in the energy sector also negatively affected shipments of oil and gas field equipment.

During the first nine months of 2003, Alberta shipments increased by 6.7 per cent, mainly as a result of higher prices. Telecom equipment volumes continued to plunge. The largest increase was recorded by the *fabricated metal products* sector, followed by *refined petroleum products*, *chemicals* and *primary metals*. The international bans on Canadian beef caused shipments by the *food* sector to drop by 2.1 per cent.

The combined effects of the US' emergence from its economic slump and the recent lifting of US and Mexican import bans of boneless beef from cattle of less than 30 months, should result in Alberta's manufacturing sector continuing to perform well during the remainder of 2003.

Alberta Manufacturing Shipments



Sources: Statistics Canada; AED

An excellent indicator for the manufacturing sector's fourth quarter outlook is Statistics Canada's Business Conditions Survey. According to the October survey, 45 per cent of Alberta manufacturers stated they would increase production in the fourth quarter, compared with 34 per cent at the national level. 10 per cent expected to decrease production, leaving the Alberta balance of opinion at +35 (Canadian balance was +18). This represents a 22-point rise from July, and

is one of the highest positive balances on record (survey started in 1992).

This sector could see strong growth in 2004. World trade volumes are forecast to see the strongest growth in four years; Alberta's major trading partners, especially the US and the rest of Canada, are expected to have very strong economic growth; and higher commodity prices are likely. The IT sector is also slowly emerging from its slump and could see positive growth next year. As a result, eight per cent growth is forecast for the manufacturing sector in 2004.

In 2002, the value of chemical shipments declined by seven per cent because of lower prices resulting from lower feedstock costs – volumes rose strongly. For the first nine months of 2003, the value of shipments increased by 14 per cent, mostly because of higher prices, driven by higher feedstock costs. Export volumes were lower, as a result of the loss of US markets for MTBE. The outlook for the remainder of 2003 is good as increased capacity should eventually lead to higher volumes, and prices are expected to stay high. Export volumes should also fare better in the remainder of 2003, as the US economy continues to recover (and MTBE exports were very low in the latter part of 2002). Increased capacity and higher world demand should lead to strong growth in 2004.

In 2003, capacity growth in the chemical industry is coming from polyethylene and linear alpha olefins (LAO) plants that became operational by the end of 2001. Nova's polyethylene plant and BP's LAO plant are now in operation. Both commodities are expected to see strong world demand growth over the next few years. Up to 50 per cent of BP's LAO production is expected to remain within Alberta to be used by polyethylene manufacturers, which previously imported this feedstock from the US.

In 2002, shipments by Alberta's food and beverage industry fell by one per cent to $9.8 billion, because of lower volumes of beef exports. Shipments were down 1.8 per cent during the first nine months of 2003, because of the border closures. The recent opening-up of the US and Mexican borders should result in a better performance of this industry in 2004.

Alberta's computer and electronic products industry ships mostly telecommunication equipment. The industry continued to be affected by the global slump in the Information and Communication Technology (ICT) sector in 2002. In 2002, the value of shipments was roughly half the 2000 value, the industry's high point.

The ICT industry's decline continued in 2003, with the value of shipments down a further 27 per cent during the first nine months. Although it appears that the global telecommunication equipment sector may finally be on the road to recovery, the pace is expected to be slow: economy.com forecasts a three per cent in decline in revenues for the US telecom equipment industry in 2003 with a modest recovery in 2004. Demand remains weak and pricing power non-existent.

A decline in investment in conventional drilling led to a nine per cent decline for Alberta's machinery and fabricated metals industries in 2002. Exports fell by three per cent, because of declines for industrial machinery, material handling equipment and pumps (most of these are used by the oil and gas field industry). In the first nine months of 2003, renewed activity in the energy sector caused the shipment

value for the two sectors combined to rise 11 per cent. It can be expected that these sectors will continue to perform well into 2004, as activity in the energy sector is expected to remain strong as a result of this year's strong oil and gas prices.

Information and Communications Technology

Alberta's Information and Communications Technology (ICT) sector includes companies engaged in producing computer & communications equipment; semiconductors & other electronic components; navigational, medical & control instruments; software/ computing products & services; and telecommunications equipment & services.

Prior to 2001, ICT was Alberta's fastest growing sector. Over the past ten years, ICT employment more than doubled, as did revenues. In 2002, Alberta's ICT sector consisted of about 7,000 companies, with 54,500 employees, revenues of $10 billion and exports totaling $2.6 billion.

Over the medium term (2003 to 2005), the goods producing side of the global ICT sector is expected to see average annual revenue growth of about seven per cent (source: Global Insight). North American revenues are expected to rise by about three per cent in 2003, held back by the weak telecom industry. Semi conductor sales have risen sharply by about 6.5 per cent this year, the highest yearly gain since 1990, while telecom equipment probably turned the corner in the second half of 2003. North American prices for ICT equipment are expected to fall by more than three per cent this year.

The weakest ICT industry remains telecom equipment, with most of its customers in the telecom service industry. The only area showing any growth is sales of routers and network equipment to businesses. The heavy investment by telecom service providers, which drove the sector in 1997 to 2000, has disappeared. The telecom service industry continues to struggle from heavy debt loads and price wars in wireless and long-distance markets. Strong capital investment by service providers will not return until 2004 at the earliest.

Relying heavily on external markets, Alberta's telecom equipment industry was affected by global reductions in IT spending in 2001 and 2002. Alberta telecom manufacturers saw their exports fall by 60 per cent between 2000 and 2002, and by a further 36 per cent in the first nine months of 2003. Overall, the goods producing side of Alberta's ICT sector, mostly telecom equipment, saw revenues plummet by one-half between 2000 and 2002.

It is estimated that ICT's service side declined by about one per cent in 2002 because of strong price competition, for instance in wired and wireless phone service. According to Statistics Canada output volumes of Alberta's ICT service sector grew by about eight per cent in 2002.

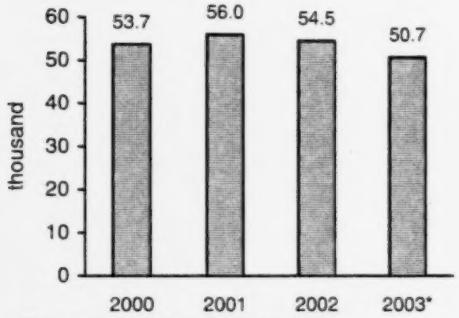
Manufacturers of computer and related equipment, a relatively small industry in Alberta, face a brighter outlook. Demand is improving because of strong sales in Asia, the recovery in the US economy and the need for businesses to upgrade aging computer systems. New orders for computers were also up 6.9% over the past year.

As a result of declining employment in the telecom service industry, Alberta's ICT employment has declined to 50,700

in the first ten months of 2003, down from 54,500 in the previous year.

Owing to an expected recovery in telecom equipment sales and a resumption of growth in ICT services, employment levels are expected to return to last year's levels sometime in 2004.

Alberta ICT Employment



Sources: Statistics Canada; AED
* Average for first 10 months 2003

Alberta's ICT service providers benefit from a very strong domestic market. The service side of the ICT sector now accounts for approximately 75 per cent of total revenues, up from 55 per cent in 2000. Telecom service provider sales total almost $5 billion, and computer related services close to $3 billion. The province is one of the most connected in Canada in computer, cell phone and internet use.

A new initiative for the ICT sector is the recently announced Alberta - California Venture Channel. Alberta based high-tech companies, which have already received financing from an Alberta source, have been introduced to venture capitalists and investors in Silicon Valley. Alberta companies will be provided with management expertise and better access to markets in the United States, and Alberta investors can partner with California investors on Alberta-based deals.

The world-wide market for nanotechnology, currently in its infancy, is forecast to grow to $1 trillion in less than 15 years (National Science Foundation). In 2002, world wide government funding for research and technology in nanotechnology exceeded $2 billion. The province has positioned itself to be at the forefront of the development of this new technology through the $120 million National Institute for Nanotechnology, to be located at the University of Alberta, and iCORE's nanotechnology research teams.

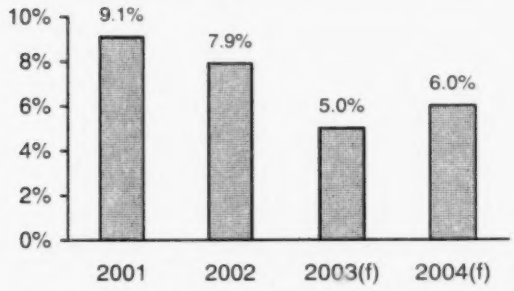
Retail Trade

Alberta led the country in retail sales growth in 2002. After growing by 7.9 per cent in 2002, Alberta retail sales are increasing at a lower rate in 2003. In the January to September period of 2003, retail sales advanced by 4.4 per cent, well above the Canadian average of 3.7 per cent. This year's increase in retail sales has been broad-based, led by strong sales growth in gasoline service stations and auto parts & services.

Sales growth in 2002 was fueled by low interest rates, lower taxes, strong inter-provincial migration and employment growth. In 2003, low interest rates and employment growth continue to provide a boost, but because the effects of lower provincial and federal taxes have dissipated, retail sales are forecast to advance at a slower pace of five per cent. Contributing to this lower growth is an expected decline in car sales, as a result of the record (and unsustainably large) numbers sold in 2001 and 2002, partly due to auto manufacturer rebates and incentives.

Alberta is expected to see slightly stronger retail sales growth in 2004, because of higher economic growth, high consumer confidence, continued in-migration and solid employment growth.

Alberta Retail Sales Growth



Sources: Statistics Canada; AED

According to the Conference Board of Canada, consumer confidence in the Prairies increased by 5.4 per cent between July and October of 2003, mainly due to Alberta's economic growth. The index now stands at its highest level in 15 months. Higher consumer confidence should eventually translate into increased purchases of motor vehicles and other big-ticket and luxury items.

TOURISM

Alberta's tourism industry, like those in most other parts of the world, had one of its worst years in recent history in 2003. It continues to face challenges in the latter part of 2003, including the lingering effects of Severe Acute Respiratory Syndrome (SARS), the uncertainty associated with the restructuring of Air Canada and continued sluggishness associated with the recovery of business travel.

Alberta is better positioned than many of its competitors and can look forward to a better year in 2004. Tourism operators in Alberta are viewing 2004 with optimism. Following a year highlighted by uncertainty and a downturn in the number of international travelers to Alberta, consensus is there will be little or no lingering negative consequences in 2004.

While long-haul markets, such as Japan and Germany, did not perform well in 2003, present indications are that pent-up visitor demand is expected from the overseas and US markets, resulting in more visitors from both in 2004. These anticipated increases, however, occur against the backdrop of several years of declines from most of Alberta's key international markets.

The Alberta resident market typically accounts for 50 per cent of the province's business; British Columbia and Saskatchewan together add another 12 to 15 per cent. Those markets in particular are expected to be strong again in 2004 (as they were in 2002 and 2003), and many operators are redirecting their marketing thrust to attract visitors from these markets.

Consumer trends that are emerging in North America in post-9/11 tend to favour Alberta and the vacation experiences the province offers:

- a desire to reconnect with traditional family values, accompanied by an increase in family travel;
- increased interest in experiencing the rural "back roads" (more interest in rural, less urban);
- strong increases in auto travel;
- the desire to stay close to home and feel safe;
- increased interest in seeking enrichment and connectedness through their travel experiences; and
- the desire to save on costs and obtain value for their vacation dollar.

Alberta is well positioned to satisfy this new consumer, particularly those in its "rubber tire" markets.

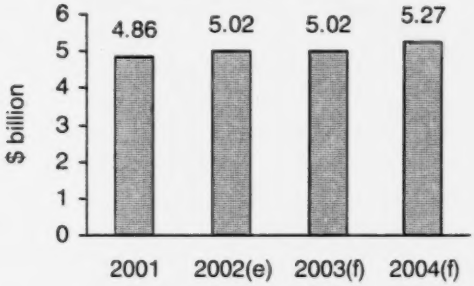
The buoyant Alberta economy is another positive factor generating travel business for the province, both in the cities and smaller centers. Hotel occupancies and revenues are expected to improve from the poor showing of 2003. Many operators are reporting strong bookings for 2004. In addition, a stronger domestic and international tourism base expected in 2004 and a return of major shows to Calgary, and the myriad of special attractions and events in celebration of the Edmonton centenary, all suggest that hotel occupancies and revenues are set to rebound in 2004.

Tourism revenues in Alberta are expected to grow by about five per cent in 2004. A strong economy, supported by a tourism marketing campaign encouraging Albertans to travel in the province, will help to increase resident travel (number of trips) by three to four per cent in 2004. A generally positive outlook for Canada's economy in 2004 is expected to result in more overnight visitors to Alberta from other provinces, especially BC and Saskatchewan.

The number of visits to Alberta by US residents in 2004 is expected to be up about four per cent, primarily due to a strengthening US economy in the second half of 2003, increased confidence in air traffic safety, and the lower threat associated with SARS. Pent-up demand for travel generally by Americans and a strong tourism marketing presence in key US markets are also expected to benefit Alberta's tourism industry.

The number of visits from overseas markets is expected to increase about six to seven per cent in 2004. Some improvement is expected from Asian markets, a trend that appears to have started in the last quarter of 2003. Visits from Japan, for example, are expected to increase about nine per cent. Stronger growth is also anticipated from Alberta's key European markets, with visits from the UK expected to increase about five per cent and from Germany by almost seven per cent.

Alberta Tourism Revenues



Sources: Statistics Canada; AED

However, in spite of the robust increase anticipated in the number of overseas and US visitors to Alberta in 2004, it will take several years of sustained growth before the number of visitors attains levels reached prior to the events of 9/11. Although growth in 2004 looks promising, it follows on the heels of several years of significant declines. The process of rebuilding a strong base of international visitors to Alberta will take several years of uninterrupted growth.

CONSTRUCTION

According to Statistics Canada's latest survey of Private and Public Investment in Canada (PPI), total capital expenditures on new construction (excluding machinery and equipment) in Alberta decreased by 2.9 per cent in 2002 to $26.7 billion. This was mainly the result of a sharp decline in drilling activity, in response to lower natural gas

prices. In 2002, construction investment in conventional oil and gas extraction declined 16.5 per cent.

Based on companies' intentions in 2003, PPI predicts that total construction investment will decline marginally by 0.2 per cent to $26.6 billion. This outlook was based on a conservative estimate of drilling activity, and on lower oil sands construction expenditures. Given the much higher than expected levels of drilling activity in recent months, 2003 investment will likely exceed $27 billion.

After falling by 12.7 per cent in 2002, energy-related construction investment is expected to remain virtually unchanged in 2003, increasing 0.2 per cent to $13.6 billion. According to PPI, conventional oil and gas extraction was expected to increase by 8.3 per cent in 2003 after declining by 16.5 per cent in 2002. Strong oil and gas prices have improved the outlook for the conventional oil and gas sector in the latter part of 2003 and could lead to continued growth in the first part of 2004.

Oil sands construction investment increased 5.8 per cent to a record $2.5 billion in 2002, but the completion of the AOSP and a number of other projects could lead to construction to drop by about one-third in 2003. Oil sands construction investment is expected to ramp up in 2004, with a number of major new projects and expansions to start either late this year or early in 2004. (Note: total oil sands investment is estimated at $6.8 billion in 2002 including $4.2 billion for machinery and equipment.)

After increasing by 9.8 per cent in 2002, non-energy investment is expected to fall by 0.5 per cent in 2003 to $13.0 billion, because of declines in manufacturing (refineries and chemicals) and education (unusually high levels of construction in 2002). However, these declines will largely be offset by increases in utilities and public administration (municipalities).

According to the Alberta Construction Association (ACA), total construction expenditures are forecast to grow by 5.2 per cent in 2004. This growth will mainly be the result of increased oil sands development activity.

Residential construction has developed strongly over the past four years. In 2002, total housing starts rose by one-third to 38,754 units.

The residential housing market is at its most active level in almost 25 years. Although total housing starts fell by 3.4 per cent during the first three quarters of 2003, compared to the same period last year, they remain at historically high levels. Single-family starts fell nine per cent, but multiple-unit starts grew seven per cent.

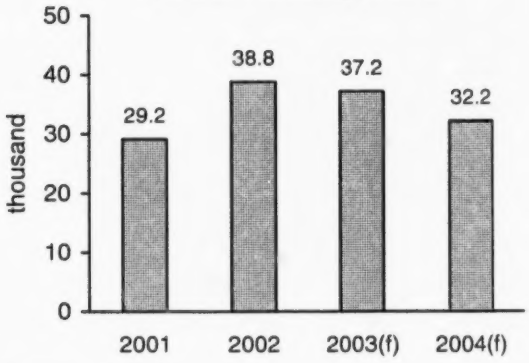
In its latest outlook report, the Canada Mortgage and Housing Corporation (CMHC) is forecasting 37,200 housing starts in Alberta in 2003, about the same level as the average of all private sector forecasts for the province.

Urban housing starts in Edmonton were especially robust (up 7.4 per cent) from January to September 2003, but Calgary starts were slightly lower (down 1.2 per cent). The high level of housing starts in the first nine months was a result of the healthy labour market, high consumer confidence, strong net migration and low interest rates.

The recent slowdown in residential permits taken out combined with the unsustainably high numbers of starts of

the past two years (housing starts have far exceeded household formation during the past few years) suggest that housing starts will be lower in 2004. The 32,200 starts forecast by the CMHC is high by historical standards – the ten-year average is 23,700.

Alberta Housing Starts



Sources: CMHC

The CMHC is expecting continued growth in Alberta's renovation market, as a result of the large number of housing re-sales and strong employment gains of the past few years. In 2003, total renovation spending is expected to rise 5.1 per cent to $2.85 billion, and further growth of about one per cent is forecast for 2004.

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You can access the Alberta Business Outlook and the following related department publications on the web at www.alberta-canada.com/statpub:

- Facts on Alberta
- Monthly Economic Review
- Inventory of Major Alberta Projects
- Inventory of Regional Alberta Projects
- Global Economic Outlook
- Alberta's International Exports
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© 2003 Government of Alberta
ISBN 0-7785-2665-8

Printed in Canada